

# **DEPOSIT INSURANCE, BLANKET GUARANTEES AND TRANSITIONING**

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## **ENHANCING CONFIDENCE: DEPOSIT INSURANCE IN THE MENA REGION**

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# Outline

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- The financial crisis and deposit insurance
- Blanket guarantees and transitioning strategies
- Selected country experiences

# The financial crisis and deposit insurance

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- Depositor protection is a critical element of stabilizing a banking system.
- Different jurisdictions used different measures depending on the severity of their financial stress and the robustness of pre-existing depositor protection arrangements
  - Some countries required little or no changes in deposit insurance
  - Others needed to increase deposit insurance coverage
  - While others were forced to adopt full blanket guarantees

# The financial crisis and deposit insurance

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## Lessons learned:

- Financial crisis exposed flaws in deposit insurance in many jurisdictions.....but well-designed (credible) systems were better able to weather the crisis than poorly designed ones. Some lessons learned include having:
  - Clear objectives and mandates to avoid coordination problems with other authorities
  - Sufficient coverage (no coinsurance)
  - Well funded (e.g. pre-funded with access to emergency back-up funding)
  - Effective information sharing/coordination
  - Capability to undertake prompt reimbursements
  - Additional resolution powers (e.g. bridge bank)
  - Public awareness in good times help in bad

# The financial crisis and deposit insurance

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- Although no deposit insurance system (by itself) can be expected to deal with a systemic crisis...the crisis showed that deposit insurance systems can play an important role by:
  - Protecting the majority of small depositors
  - Possibly administering extension of guarantees in a crisis (e.g. temporary blanket guarantees)
  - Ensuring banks contribute to the costs of resolution in some manner
  - Possibly administering asset management and liquidation vehicles (e.g. AMC, RTC)
  - Acting as a transition target when financial stability returns

# The financial crisis and deposit insurance

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- Crisis reinforces need for improving the robustness deposit insurance systems
- Key areas where improvements needed:
  - Coverage, payout speed, public awareness, funding and other design features
  - Information sharing and coordination
  - Coordinated strategies on applying and exiting blanket guarantees
  - Burden sharing (e.g. cost recovery)
- IADI/BCBS Core Principles provide guidance in many of these areas -- but need further development.

# Blanket guarantees and transitioning strategies

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- Crisis response has included the use of many tools such as:
  - Provision of central bank emergency liquidity support
  - Expansion of guarantees on deposits and other instruments
  - Capital injections and other forms of open bank assistance
  
- Use of blanket guarantees contributes to stability but creates problems:
  - Moral hazard
  - Competitive distortions
  - Potential fiscal costs

# Blanket guarantees and transitioning strategies

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- Moral hazard can be mitigated by using:
  - Limits on types of debt covered
  - Duration limits
  - Pricing and fees
  - Commitment to undertake financial sector reforms
  
- But, never completely...

# Blanket guarantees and transitioning strategies

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- As the worst of the crisis recedes, attention turning to how to transition from blanket guarantees.
- In general, exiting to limited coverage deposit insurance should occur as quickly as circumstances permit.
- Timing can be immediate -- but more often a gradual process due to circumstances.
  - In some countries transition has been relatively quick (e.g. Sweden and Jamaica)
  - In others longer (Mexico and Indonesia)

# Blanket guarantees and transitioning strategies

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- Factors influencing the timing and approach to transitioning:
  - Has financial stability returned?
  - Public attitudes and expectations – before and during transition.
  - Have other necessary institutional reforms been made – supervision, legal, accounting etc.
  - What are you exiting to – a pre-existing deposit insurance system or a new system?
  - Bank restructuring and asset disposition progress (e.g. AMC's, privatization)
  - Cross-border coordination

# Blanket guarantees and transitioning strategies

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- Other issues that need to be addressed:
  - Who leads the transitioning?
  - How will the coverage limits/scope be withdrawn and in what sequence?
  - Dealing with product maturities (e.g. grandfathering)?
  - Cost recovery and mitigating pro-cyclicality

# Selected Country Experiences Transitioning from Blanket Guarantees (1993-2005)

Source: IADI Survey 2005

Country	Period	Duration	Extended	#. of Extensions	Reason for Extension	DIS in Place at Time of Transition	Transition Approach	Notes
1. Sweden	1993.1~1996.7	~4 yrs	No			No	Fast	Blanket guarantee cancelled with the implementation of DIS in July 1996
2. Finland	1993.2~1998.12	~6 yrs	No			Yes	Fast	
3. Japan	1996.6~2002.3 (	~6 yrs	Yes	1	Banking sector was not suitable for terminating the blanket guarantee	Yes	Gradual	
4. Korea	1997.12~2000.12	~3 yrs	No			Yes	Fast	

# Selected Country Experiences Transitioning from Blanket Guarantees (1993-2005)

Source: IADI Survey 2005

<b>5. Thailand</b>	1997~	7+ yrs				No	Not Stated	Blanket guarantee to be lifted with establishment of DIS in 2006
<b>6. Malaysia</b>	1998~ 2005.8	7+ yrs				No	Fast	DIS was established on Sep 1, 2005 to replace the blanket guarantee.
<b>7. Indonesia</b>	1998.1~ 2007.1	8 yrs	Yes	1	Need for further financial market stabilization	No	Gradual	Blanket guarantee to be lifted with establishment of DIS in Feb. 2007
<b>8. Taiwan</b>	2001.7~ 2005.7	4 yrs	Yes	1 (note3)	Ongoing disposal of problem institutions; financial reforms	Yes	Fast	
<b>9. Turkey</b>	2000.12~2004. 7	~4 yrs	No			Yes	Gradual	
<b>10. Jamaica</b>	1997.1~ 1998.8	~2 yrs	No			No	Fast	Blanket guarantee lifted with establishment of DIS in Aug. 1998
<b>11. Mexico</b>	1990~ 1999	~10 yrs	No			Yes	Gradual	DIS established in 1999; limited coverage commenced in Jan. 2005

# Top three roadblocks to transitioning?

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1. Insufficient coordination among safety net authorities in sequencing reforms
2. Lack of resources to handle insolvent banks and their restructuring
3. Political bias to delay transitioning in many countries.

Source: Case Studies on Transitioning, FSF Working Group on Deposit Insurance (2001).

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# QUESTIONS